



0000150106

BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
CHAIRMAN
GARY PIERCE
COMMISSIONER
BRENDA BURNS
COMMISSIONER
BOB BURNS
COMMISSIONER
SUSAN BITTER SMITH
COMMISSIONER

2014 JAN 31 P 12:57

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

JAN 31 2014

ORIGINAL

DOCKETED BY

IN THE MATTER OF THE APPLICATION OF
LITCHFIELD PARK SERVICE COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANTS AND PROPERTY AND
FOR INCREASES IN ITS WASTEWATER
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE.

Docket No. SW-01428A-13-0042

IN THE MATTER OF THE APPLICATION OF
LITCHFIELD PARK SERVICE COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANTS AND PROPERTY AND
FOR INCREASES IN ITS WATER RATES
AND CHARGES BASED THEREON FOR
UTILITY SERVICE.

Docket No. W-01427A-13-0043

RUCO'S REPLY BRIEF

INTRODUCTION

The Residential Utility Consumer Office ("RUCO") submits this Brief in reply to the Opening Briefs submitted by the Company and Staff in the above referenced matter. RUCO continues to support the Settlement but opposes the SIB/CSIB.

1 For the most part, RUCO has addressed the key points raised by the Company and
2 Staff on the SIB/CSIB in RUCO's Opening Brief. Not surprisingly, neither the Company nor
3 Staff really addressed the evidentiary issues (or lack of evidence) that RUCO raised in its
4 Opening Brief. Obviously, neither the Company nor Staff perceive the issue and no doubt will
5 address it in their Reply Briefs. RUCO briefed that issue in its Opening Brief and continues to
6 stand by the arguments made in its Opening Brief.

7 While not necessarily an evidentiary point, the Company maintains that the SIB and
8 CSIB are fundamentally the same as the SIB the Commission approved in the AWC Eastern
9 Division case. Company Brief at 6. RUCO does not take issue with the fact that many of the
10 provisions are similar but there are clearly differences in both the SIB and the CSIB. See
11 RUCO's Opening Brief at 11-16. The CSIB addresses wastewater infrastructure and that is a
12 huge difference – the Eastern Division SIB only addressed AWC's water infrastructure.
13 Among many other things, neither the Company nor Staff has shown why such a mechanism
14 is necessary for a wastewater system. It is not enough to assume that a wastewater
15 surcharge mechanism is necessary in this case just because the Commission has in the past
16 approved a water mechanism for other utilities. Again, the facts of this case are different, the
17 circumstances of this case are different, and the needs of this Company are different. A
18 "template" from another case which has been modified in this case needs to be scrutinized to
19 the same level in this case to make sure its provisions are relevant and applicable to the
20 different circumstances of this case.

21 Both the Company and Staff maintain that the SIB is legal, and that RUCO has not
22 provided a valid argument for rejecting the SIB/CSIB in this case. Staff Brief at 12-14,
23 Company Brief at 11-22. Obviously, RUCO disagrees for the reasons set forth in its Opening
24 Brief and the underlying case - the challenge here is to reply to the arguments made without

1 being redundant. The gist of the Company and Staff's legal arguments square up with the
2 legal reasoning in the Eastern Division, Phase II Decision - Decision No. 73938, which is
3 currently under reconsideration. The ROE aspect of the disputed issues in that case is not at
4 issue in this case – the legal issue here is simply the legality of the SIB. RUCO believes the
5 SIB is illegal and at the risk of not being to redundant, will reply to the points raised by the
6 Company and Staff in their Opening¹ Briefs.

7 **1) THE SIB/CSIB IS NOT AN ADJUSTOR MECHANISM**

8 At the heart of the legal debate is the question of whether the SIB is an adjustor
9 mechanism. An adjustor mechanism is one exception to Arizona's constitutional fair value
10 requirement. See *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 535, 578 P.2d 612, 616;
11 *Residential Util. Consumer Office v. Arizona Corp. Comm'n ("Rio Verde")*, 199 Ariz. 588, 591 ¶
12 11, 20 P.3d 1169, 1172. The Commission in Phase II of the Eastern Division Case determined
13 that the SIB in that case is an adjustor mechanism. Decision No. 73938 at 52. The Company
14 references the Commission's Decision and makes several arguments in support of its position
15 that the SIB/CSIB is an adjustor mechanism. Company Brief at 16-22. The Staff argues that
16 the SIB/CSIB comports with the fair value requirement. Staff Brief at 8-12. Staff's belief that
17 the SIB/CSIB comports with fair value perhaps explains why Staff does not address the
18 adjustor mechanism issue. Nonetheless, the Company, in support of its argument that the
19 SIB is an adjustor mechanism, points out Mr. Olea's testimony in the AWC Case wherein Mr.
20 Olea testified that the SIB is an adjustor mechanism. Company Brief at 15, Transcript from
21 April 11, 2012 hearing at 297-298.

22
23
24

¹ Staff called its Brief - "Staff Opening Brief", the Company called its Brief – "Initial Closing Brief". For ease, RUCO will refer to both Briefs as "Opening Briefs".

1 The Company argues that the SIB, "boiled down" is, an adjustor mechanism. Company
2 Brief at 15. RUCO is puzzled how the Commission, the Company and Staff² can read the
3 *Scates* requirements in any manner different than its simple meaning. An automatic adjustor
4 mechanism permits rates to adjust up or down "in relation to fluctuations in certain, narrowly
5 defined, operating expenses." *Scates* at 535, 578 P.2d 616. An automatic adjustor permits a
6 utility's rate of return to remain relatively constant despite fluctuations in the relevant expense.
7 An automatic adjustor clause can only be implemented as part of a full rate hearing. *Rio Verde*
8 at 592 ¶ 19, 20 P.3d 1173, *citing Scates* at 535, 578 P.2d 616. Water and Wastewater Plant is
9 not narrowly defined operating expenses and the SIB/CSIB will only result in upward
10 fluctuations – not downward. Plant is a component of ratebase, not operating expenses.
11 Regardless of the reasons for the *Scates* definition, the language is clear, and the Arizona
12 Courts have never expanded the definition.

13 *Scates* provides additional insight as to the reasons for an automatic adjustor clause
14 which clearly show that automatic adjustors are not meant to pass through plant costs.

15 ... Such clauses usually embody a formula established during a rate
16 hearing to permit adjustment of rates in the future to reflect changes in
17 specific operating costs, such as the wholesale cost of gas or electricity. E.
18 g., Consumers Organization for Fair Energy Equality, Inc. v. Department of
Pub. Utilities, 335 N.E.2d 341, 343 (Mass.Sup.Jud.Ct.1975); City of Norfolk
v. Virginia Electric & Power Co., 197 Va. 505, 90 S.E.2d 140, 148 (1955).

19 "(T)he impact of certain increased or decreased costs are passed on to
20 the consumer so that the utility neither benefits from a decreased cost nor
21 suffers a diminished return as a result of an increase in a cost covered by
22 the adjustment clause." 71-15 Op. Att'y Gen. (1971).

23 Thus, although a utility may receive increased gross revenues when
24 utility rates increase under automatic adjustment clauses, a utility's net
income should not be increased, because operating costs also will have
risen to offset the increased revenue. See Maestas v. New Mexico Pub.
Serv. Comm'n, 85 N.M. 571, 514 P.2d 847 (1973).

² Assuming Staff still considers the SIB/CSIB an adjustor mechanism.

1 *Id.*

2 Scates made it clear that adjustor clauses apply to the type of costs that fluctuate
3 greatly such as "... the cost of wholesale cost of gas and electricity". *Scates* at 616. The
4 reasoning behind the automatic adjustment clause is to allow the company to recover narrow
5 and specific costs that fluctuate up and down often like gas and electric which are outside of
6 the utilities control. A pass-through of those costs is reasonable and makes sense. The
7 Commission has followed *Scates* on that line of reasoning. See Decision No. 56450, page 6,
8 April 13, 1989, RUCO's Opening Brief at 5-6. Routine plant does not fluctuate widely and the
9 SIB/CSIB only will address increases in plant costs. There are other reasons why routine plant
10 of this magnitude should not be made a pass-through – i.e. while both the Company and Staff
11 will argue that Staff will scrutinize this plant, it is clear from the size of the engineering reports
12 in this case that such a task will be burdensome for Staff, and given the type of scrutiny Staff
13 has done initially in approving the engineering reports (see RUCO Brief at 15-16) there
14 remains a concern. Clearly, the types of costs contemplated by *Scates* do not include routine
15 plant with a corresponding return.

16 *Scates* further explained, citing the *Maestas v. New Mexico* case, that under an
17 automatic adjustment clause, a utilities net income should not increase. *Id.* That is exactly
18 what will happen with the SIB/CSIB. Each SIB/CSIB filing will add new plant to the Company's
19 rate base which will increase the Company's net income. That increase will be greater than
20 the plant cost because under the SIB/CSIB the Company will be allowed to recover a return on
21 the SIB/CSIB plant. Nowhere does the concept of an automatic adjustor include a return on
22 the cost. Under the SIB/CSIB the Company's increased revenues will outweigh the plant cost
23 (less depreciation expense) which again falls outside the *Scates* definition of an adjustor
24 exception.

1 Somewhere along the line, the Commission has expanded the definition of the adjustor
2 mechanism to the point where Companies are now actually arguing that surcharge
3 mechanisms for routine plant and a return now qualifies as an adjustor mechanism. As a
4 general policy embedded in the law, Courts have long held that when it comes to exception to
5 a constitutional requirement, the exception should be a narrowly construed, not liberally
6 construed. See *Laos v. Arnold*, 141 Ariz. 46, 685 P.2d 111 (1984) and *Spokane & I.E.R. Co.*
7 *v. U.S.*, 241 U.S. 344, 350, 36 S.Ct. 668, 671 (1916). The Arizona Constitution protects
8 consumers by generally requiring that the Commission only change a utility's rates in
9 conjunction with making a finding of the fair value of the utility's property.³ The Commission
10 should take precaution when considering exceptions to Arizona's Constitution and heed the
11 Opinions of the Court.

12 Nonetheless, the Company insists on trying to fit a square peg in a round hole. The
13 Company's arguments are not persuasive. The Company argues that RUCO did not oppose
14 the EIS in the APS case which is a similar type mechanism. Company Brief at 19-22. Whether
15 or not RUCO opposed the EIS in the APS case has no bearing on whether the SIB/CSIB is
16 legal. The EIS is a different mechanism in a different case which had different circumstances
17 – the argument is a red herring. Further, the Company's legal opinion of RUCO's legal status
18 in a contractual relationship in another case in which the Company was not even a party is
19 simply out of order, and of no relevance in this case. Company Brief at 20.

20 The Company further argues that the SIB is a type of DSIC, and Courts in other states
21 have recognized that DSIC's are adjustor mechanisms. This is another empty argument. One
22 needs to look no farther than Staff's position on the SIB and DSIC type mechanisms. There is
23

24 ³ Arizona Constitution. Art. XV, § 14; *Simms v. Round Valley Light & Power Company*, 80 Ariz. 145, 151, 294
P.2d 378, 382 (1956); see also *State v. Tucson Gas*, 15 Ariz. 294, 308; 138 P.781, 786 (1914); *Arizona
Corporation Commission v. State ex rel. Woods*, 171 Ariz. 286, 295, 830 P.2d 807, 816 (1992).

1 no dispute that the SIB is a type of DSIC. Staff in Phase one of AWC's Eastern Division case
2 argued that the proposed DSIC was an adjustor mechanism. Decision No. 73736 at 100. In
3 this case, Staff claims that the SIB meets Arizona's Fair Value requirement. Despite Mr.
4 Olea's testimony, if the SIB meets the fair value requirement, then it necessarily follows that it
5 is not an adjustor mechanism – adjustor mechanisms are exceptions to Arizona's fair value
6 requirement. The point – not all DSIC's are the same and whether one qualifies as an adjustor
7 depends on the particular mechanism as well as the state's legal definition of an adjustor
8 mechanism.

9 All said, the SIB/CSIB is not an adjustor mechanism in Arizona.

10
11 **2) THE SIB/CSIB WOULD NOT QUALIFY UNDER THE 'THIRD EXCEPTION'**
12 **NOR WILL IT INCREASE THE COMPANY'S RATE BASE WITH A**
CORRESPONDING DETERMINATION OF FAIR VALUE

13 To the extent the parties raise the so called "third-exception" argument, RUCO would
14 refer to its Opening Brief at 7 – 8. There is nothing exceptional about the plant in question – it
15 is routine plant needed to provide service. This same issue of exceptional circumstances
16 came up in AWC's Eastern Division case. Staff's Director, Steve Olea provided insight - Staff
17 concluded that the Company had not demonstrated extraordinary circumstances in the Phase I
18 case to justify AWC's original DSIC proposal. See Arizona Water Company, Docket No., W-
19 01445-11-0310, Phase II Transcript at 301). When asked in Phase II what had changed, Mr.
20 Olea responded the Commission's request that the parties were all directed to talk about the
21 DSIC. Id. In Staff's view, a Commission directive to look at the DSIC constitutes an
22 extraordinary circumstance. Staff's definition of "extraordinary" is even more murky and
23 inconsistent when one considers that the Commission in the last AWC company-wide rate
24 case ordered the Company to do a DSIC study and report on it in the its next case – which

1 was the Eastern Division case. Decision No. 73736 at 14-15. While it does not appear that
2 Arizona's case law defines extraordinary or exceptional, it is doubtful that it would include the
3 Commission's directive. For example, *Scates* did define what was needed for interim rates –
4 an emergency which is far more tangible than a mere directive. *Scates v. Ariz. Corp. Comm'n*,
5 118 Ariz. 531, 535, 578 P.2d 612, 616 (App. 1978).

6 Putting the Constitutional exceptions aside, both the Company and Staff suggest that
7 the SIB filings require a fair value finding. The Company claims that the Commission "...will
8 make a fair value finding in setting rates" as a part of the SIB/CSIB filings. Company Brief at
9 16. Staff states that the information required with each filing will enable the Commission to
10 update the fair value rate base and determine the impact of the revenues. Staff Brief at 8.

11 Both Staff and the Company's position begs the question of why the Commission past
12 finding that the SIB is an adjustor mechanism⁴ is necessary if the SIBCSIB results in a fair
13 value finding. Stated another way, if the SIB/CSIB mechanism is an exception to a fair value
14 finding, then it is an oxymoron to say that the SIB/CSIB mechanism will result in a fair value
15 finding.

16 In truth, there is no guarantee that each SIB filing will result in a fair value rate base
17 finding. In a rate case, the Commission looks at and considers all of the Company's proposed
18 plant additions as part of its rate base. The Commission will deduct from the rate base
19 different rate case elements such as AIAC and CIAC. The Commission will consider operating
20 expenses associated with that plant. The Commission will consider all the rate case elements
21 associated with that plant and based on that, make a finding of fair value.

22 With each SIB/CSIB filing, the Company will add only the post-test year SIB/CSIB plant
23 and the depreciation expense associated with it. Transcript at 101, Decision No 73938,

24 _____
⁴ See Decision Nos. 73938, 74081.

1 Settlement Agreement Schedule D. All of the other filings that Staff and the Company discuss
2 at length – the earnings test schedule, the rate review schedule, the typical bill analysis, and
3 on and on will be provided but not included in the Company's proposed plant increase. Each
4 SIB filing will not include any non-SIB related plant, and operating expenses associated with
5 the plant (except depreciation expense). Id. In sum, each filings "update" will be the SIB
6 related gross plant and depreciation expense.

7 The SIB filings will focus on one issue –the SIB related plant. RUCO has raised the
8 concern of "single issue" ratemaking. Staff discounts the concern, questioning its origin and
9 noting that it is not referenced in Arizona's Constitution. Staff Brief at 11. The irony in Staff's
10 position, is that it appears⁵ that it was Staff who first coined the notion in the *Scates* case – to
11 support its position regarding such ratemaking.

12 In this case, the Corporation Commission approved an increase of
13 almost five million dollars on the rates charged for certain services with no
14 concomitant reduction in the charges for other services. The resulting net
15 increase in revenue to the utility was accomplished without any inquiry
16 whatsoever into whether the increased revenues resulted in a rate of return
17 greater or lesser than that established in the rate hearing some ten months
18 before. All evidence bearing on the subject was expressly rejected.
19 Although all parties before the Commission generally agreed that it would
20 be improper to implement an increase of all rates without such inquiry, we
21 see no justification for permitting the same increase in revenues to be
22 accomplished by raising only some of the tariffs. **As special counsel for
23 the Commission's staff pointed out during the course of this hearing,
24 such a piecemeal approach is fraught with potential abuse.** Such a
practice must inevitably serve both as an incentive for utilities to seek rate
increases each time costs in a particular area rise, and as a disincentive for
achieving countervailing economies in the same or other areas of their
operations.

Scates v. Ariz. Corp. Comm'n, 118 Ariz. 531, 535, 578 P.2d 612, 616 (App. 1978) (Emphasis
Added). RUCO is not suggesting the Constitution specifically prohibits "single issue

⁵ RUCO has not seen the phrase in any prior case.


1 ratemaking" – RUCO does believe that the Constitution requires a finding of fair value, and the
2 notion of "single issue ratemaking" is problematic to a fair value finding on its face.

3 Staff also argues that the SIB/CSIB will allow the Commission to discharge its duties of
4 finding fair value because of all the additional information the Company has to file. Staff
5 further claims it is inappropriate for RUCO to presume that the Commission will not
6 appropriately consider this information. Company Brief at 9 -12. Staff's argument misses the
7 point. RUCO is not presuming anything. The SIB/CSIB filings will not require any calculation
8 of fair value – all they require is the Company to add the SIB related plant cost to the fair value
9 rate base authorized in the rate case, allow a return on the additional plant, all of which will
10 raise rates. Staff's argument presumes that all of the other information the Company will file
11 will somehow make the Company's request compliant with fair value. Staff's argument lacks
12 merit.

13
14 **3) CONCLUSION**

15 For all of the reasons stated in RUCO's Opening and Reply Briefs, the Commission
16 should approve the Settlement and reject the SIB/CSIB.

17
18 RESPECTFULLY SUBMITTED this 31st day of January, 2014.

19
20
21 
22 Daniel W. Pozefsky
23 Chief Counsel
24

1 AN ORIGINAL AND THIRTEEN COPIES
2 of the foregoing filed this 31st day
3 of January, 2014 with:

4 Docket Control
5 Arizona Corporation Commission
6 1200 West Washington
7 Phoenix, Arizona 85007

8 COPIES of the foregoing hand delivered/
9 mailed this 31st day of January, 2014 to:

10 Teena Jibilian
11 Administrative Law Judge
12 Arizona Corporation Commission
13 1200 West Washington
14 Phoenix, Arizona 85007

15 Janice Alward, Chief Counsel
16 Legal Division
17 Arizona Corporation Commission
18 1200 West Washington
19 Phoenix, Arizona 85007

20 Steve Olea, Director
21 Utilities Division
22 Arizona Corporation Commission
23 1200 West Washington
24 Phoenix, Arizona 85007

Jay L. Shapiro
Fennemore Craig, PC
2394 E. Camelback Rd., Suite 600
Phoenix, Arizona 85016
Attorneys for LPSCO

Olivia Burnes
356 N. Cloverfield Circle
Litchfield Park, AZ 85340

21
22 By Cheryl Fraulob
23 Cheryl Fraulob
24